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Delegation of Investment Discretion to Investment Adviser Does Not Create 13(d) Group with Adviser or its Other Advisees

A judge in the SDNY has issued a potentially significant decision regarding the circumstances under which a person who delegates investment discretion to an investment adviser will be deemed to have formed a 13(d) "group" with the adviser and/or its other advisees. See *Rubenstein v. IVA*.

The case involves a registered investment adviser that caused its advised funds and a managed account to purchase, in total, more than 10% of the common stock of DeVry Education Group. The adviser and its control persons filed a 13G reporting all of the shares purchased but did not file a Form 3 because they qualified for the RIA and control person exemptions in Rule 16a-1(a)(1)(v) and (vii). The adviser subsequently developed a control purpose regarding DeVry, resulting in loss of the Section 16 exemption, so the adviser and its control persons converted to filing on Schedule 13D and filed a Form 3. Thereafter, the managed account allegedly engaged in a short-swing trade, resulting in a profit of approximately $327,000. The plaintiff brought a 16(b) action against "John Doe," as owner of the managed account, as well as against the adviser and its control persons, alleging that John Doe was subject to Section 16 as a ten percent owner because it had formed a group with the adviser and/or the advised funds.

The defendants moved to dismiss the complaint on the ground that the investment advisory agreement between John Doe and the adviser, which merely gave the adviser investment and voting power over John Doe's account, was not an agreement relating to DeVry stock and therefore did not give rise to a group. The plaintiff countered that the investment advisory agreement related to the acquisition of whatever securities the adviser chose to purchase for the managed account, and therefore created a group regarding DeVry. The plaintiff also argued that the adviser's filing of a 13D put John Doe and the advised funds on notice that they were participants in an effort to influence control of DeVry, and that their failure to terminate the adviser's authority constituted an implied agreement to join a group.

The court rejected both arguments and dismissed the complaint. First, the court said that investors don't form a group with one another just by hiring the same investment adviser, even if the adviser causes all of them to invest in the same securities. Formation of a group requires that the members have a common objective, the court said, and Rule 13d-5(b)

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requires that the investors agree to act together regarding the securities "of an issuer." The court interpreted this language to mean that, for a group to exist, the agreement must relate to the securities of a "particular issuer." Because John Doe did not agree to invest specifically in DeVry common stock, John Doe did not form a group with the adviser or its advised funds. The court distinguished recent cases holding that a group may exist where investment funds under common management invest in the same securities, noting that, in those cases, either the funds had common owners or the Rule 13d-5(b) issue wasn't raised by the parties.

The court gave short shrift to the argument that the filing of the 13D created a group, holding that an agreement can't be inferred where there is no allegation that the advisee was even aware of, much less agreed to, the advisers control purpose.

Posted by Alan Dye at 8:36 am

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